

REPORT FOLLOW-UP

AGENCY: DEPARTMENT OF ENVIRONMENTAL QUALITY – CLEAN WATER STATE REVOLVING FUND

On April 5, 2005, the Legislative Services Office released an audit report for the Department of Environmental Quality – Clean Water State Revolving Fund for fiscal year 2004. The Department was contacted on July 8, 2005, and this follow-up report addresses how it has responded to the three findings and recommendations contained in that report.

STATUS OF RECOMMENDATIONS:

Finding #1 – The Department had not invested available cash in the State Treasurer's long-term investment pool to increase earnings. Closer monitoring of cash needs and investing in longer term investments would improve investment earnings. The Fund has more than \$69 million in cash. Much of this cash is not needed immediately and could be invested in longer term investments to earn higher yields. An interest rate increase of just 1% would yield about \$600,000 in one year; a 3% increase would yield about \$1.8 million in one year.

We recommended that the Department complete a cash flow analysis and, based on the results, consider making long-term investments. The Department should also complete cash flow analyses periodically, and consider laddering the investment maturity dates to maximize earnings.

Audit Follow-up – The Department now completes a cash flow projection each month. It has placed a total of \$44 million in the State Treasurer's long-term investment pool, \$40 million of which is from the Clean Water Revolving Loan Fund.

STATUS - CLOSED

Finding #2 – The Department's system used for the Fund's accounting is cumbersome and contributes to accounting errors. The accounting system is more than 15 years old and requires multiple transactions and data entries. It also requires peripheral systems to complete necessary accounting, increasing the opportunity for errors. Only one fiscal employee had the knowledge to operate and access the system, thus increasing the risk that funds could be misappropriated and that errors may go undetected.

Additionally, the Department did not complete financial statements in a timely manner, did not reconcile certain transactions recorded in the State's accounting system (STARS) to transactions recorded in the Fund's accounting system, and used three fund details and many program codes in the State's accounting system when one fund detail and fewer program codes would suffice.

We recommended that the Department upgrade and improve its accounting system and procedures. This should include the following:

1. Consider purchasing a new integrated accounting system. It is likely that the Department can purchase an "off the shelf" inexpensive software program that would satisfy its needs.
2. Ensure that more than one person is trained to complete the Fund's accounting.
3. Generate accounting reports in a timely manner, and ensure that management review the reports to monitor financial activities.
4. Complete all accounting and reconciliation of transactions in one fund detail and reduce the number of program codes.

Audit Follow-up – The Department is in the process of reviewing new accounting software. When the Department obtains new software, more than one person will be trained to use it. The new software will also allow for easier generation of accounting reports for management review. Additionally, the Department is considering reducing or eliminating some fund details and program codes.

STATUS – IN PROCESS

FINDING #3 – Documentation in the loan files was not always adequate to support loan transactions or decisions. The Department could not provide adequate documentation for some transactions. This lack of documentation places the Department at risk should a local entity contend that it did not agree to the new conditions. Good documentation will also protect employees from potential allegations of wrongdoing. The following are examples of missing documentation and areas needing improvement:

1. The Department could not provide adequate documentation explaining why interest was not accrued for certain periods on several loans. As a result, more than \$150,000 in interest was not charged and may not be collected.
2. The Department could provide no addendums to the loan agreements or correspondence in the loan files to indicate that all parties agreed to the re-amortization of certain loans.
3. There was no documentation explaining the reasons for encouraging several local entities to refinance their loans by issuing local bonds.
4. There was no documentation explaining why loan amounts recorded in the accounting system (the loan detail report) and amounts placed in the loan closing documents did not always agree to the beginning loan amortization amounts.

We recommended that the Department document all decisions that affect the loans or transactions related to them. The loan files should include the following:

1. Justification and management approval for not accruing interest on loans.
2. Justification and support, including management approval and the local entity's concurrence, for loan re-amortizations.
3. Explanations and loan analyses, including cash flow projections, investment earnings impact, and other options, prior to encouraging local entities to refinance their loans.
4. Documentation explaining variances in loan amounts reported on loan detail reports and loan amortization schedules.

Audit Follow-up – The Department intends to write policies requiring documentation for loan decisions, and such documentation will be placed in the loan files. The staff has been informed of the forthcoming policies.

Status – IN PROCESS